What We’ve Learned From Tax Reform

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Agenda

- Highlight key items of tax reform
- Bonus depreciation
- Real property trade election
- Pass-through business deduction
- Parking fringe benefits
- Entity structure
- Additional Opportunities

Reduced Corporate Tax Rates

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Previous Law</th>
<th>TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0–$50,000</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>$50,001–$75,000</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>$75,001–$100,000</td>
<td>34%</td>
<td></td>
</tr>
<tr>
<td>$100,001–$335,000</td>
<td>39%</td>
<td>21%</td>
</tr>
<tr>
<td>$335,001–$10,000,000</td>
<td>34%</td>
<td></td>
</tr>
<tr>
<td>$10,000,001–$15,000,000</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>$15,000,001–$18,333,333</td>
<td>38%</td>
<td></td>
</tr>
<tr>
<td>More than $18,333,333</td>
<td>35%</td>
<td></td>
</tr>
</tbody>
</table>
Reduced Individual Income Tax Rates

<table>
<thead>
<tr>
<th>Rate*</th>
<th>Bracket</th>
<th>Rate*</th>
<th>Bracket</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0–9,525</td>
<td>10%</td>
<td>$0–9,700</td>
</tr>
<tr>
<td>12%</td>
<td>9,526–38,700</td>
<td>12%</td>
<td>9,701–39,475</td>
</tr>
<tr>
<td>22%</td>
<td>38,701–82,500</td>
<td>22%</td>
<td>39,476–84,200</td>
</tr>
<tr>
<td>24%</td>
<td>82,501–157,500</td>
<td>24%</td>
<td>84,201–160,725</td>
</tr>
<tr>
<td>32%</td>
<td>157,501–200,000</td>
<td>32%</td>
<td>160,726–204,100</td>
</tr>
<tr>
<td>35%</td>
<td>200,001–500,000</td>
<td>35%</td>
<td>204,101–510,300</td>
</tr>
<tr>
<td>37%</td>
<td>More Than 500,000</td>
<td>37%</td>
<td>More Than 510,300</td>
</tr>
</tbody>
</table>

*Plus 3.8 percent net investment income tax on unearned income when modified adjusted gross income exceeds $200,000 ($250,000)
Expires after December 31, 2025

Repealed Corporate AMT

- Permanent repeal for tax years beginning after December 31, 2017
- Remaining alternative minimum tax (AMT) credits refundable
  - 2018–2020 tax years
    - Reduce regular tax liability by any available AMT credit
    - 50 percent of any excess AMT credit is refundable
  - 2021 tax year
    - Any remaining AMT credit carryforward is refundable
Limited or Eliminated Deductions

• Business entertainment
  • Eliminated 50 percent deduction for amounts paid or incurred after December 31, 2017
  • Amounts for expenses previously fully deductible under specific exceptions are retained

• Business meals for employers
  • Limited deduction for amounts paid or incurred for otherwise allowable food/beverage expenditures to 50 percent
  • Certain exceptions still allow a full deduction

Limited or Eliminated Deductions

• Business meals for employees
  • Did not change under the TCJA
  • Value of food/beverages provided is excluded from employee’s income if it fits into one of these categories
    • Meals provided as a de minimis fringe benefit, e.g., coffee & doughnuts
    • Meals provided at an on-premises, employer-operated eating facility that are considered a de minimis fringe benefit, e.g., a cafeteria
    • Meals provided to employees for convenience of employer at employer’s business location, e.g., meal provided to an employee over lunch so he/she is there to take an emergency call
• Enhanced bonus depreciation
  - October 5, 2017–December 31, 2022 – 100 percent
  - Reduces by 20 percent per year thereafter through 2026
  - Available for both new & used assets
  - Made changes to qualified improvement property, creating unintended need for technical correction
  - Does not impact accounting for long-term contracts

• Expanded §179
  - Up to $1,020,000 for 2019 (adjusted annually for inflation)
  - Phase out beginning at $2,550,000 of assets placed in service for 2019
  - Definition of qualified property expanded to include certain improvements to nonresidential real property, including roofs, HVAC systems, fire protection & alarm systems & security systems
Modified & Added Loss Limitations

Net Operating Loss (NOL)
- Modified NOL deduction
- Limits deduction to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017
- May generally not be carried back
- Carried forward indefinitely

Excess Business Loss Limitation
- Limits aggregate deductions attributable to trades or businesses over the aggregate gross income/gain to $255,000 for single filers ($510,000 MFJ) in 2019
- Any excess losses treated as an NOL

Limited Business Interest Expense

- Deduction generally limited to sum of
  - Business interest income
  - Floor plan financing interest
  - 30 percent of adjusted taxable income (ATI)
**Limited Business Interest Expense**

• ATI = taxable income with following adjustments
  - +/- items of income, gain, deduction or loss not properly allocable to trade/business
  - + depletion, depreciation & amortization for taxable years beginning before January 1, 2022
  - + net business interest expense
  - + NOL
  - + QBI deduction

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**Limited Business Interest Expense**

• Limitation does not apply to
  - Businesses with average gross receipts ≤ $25 million (affiliated group basis)
  - Regulated public utility businesses including electric cooperatives
  - Real property businesses & farming businesses (including agricultural & horticultural cooperatives) may elect not to be subject to limitation provided they use ADS method for depreciation
Limited Business Interest Expense

- Real property trades can elect out of provision
  - Requires depreciation of residential & nonresidential property under ADS lives (30 & 40 years respectively)
- What trades qualify?
  - Real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing or brokerage trade or business

Created New 20 Percent Deduction

- New IRC Section 199A provides 20 percent deduction of domestic qualified business income (QBI) for individuals, trusts & estates for 2018–2025 tax years
- When taxable income exceeds $160,700 ($321,400 for joint filers or surviving spouse) in 2019, limitations partially apply until taxable income reaches $210,700 ($421,400)
  - W-2 wages
  - Qualified property
  - Specified service trade or business

Expires after December 31, 2025
**Created New 20 Percent Deduction**

- Aggregation options
  - 50% or more common ownership
  - Ownership exists for majority of year including last day of tax year
  - Can’t aggregate with an SSTB
  - Must meet two of the following:
    - Businesses are similar or products, property or services are commonly sold together.
    - Centralized business management or facilities
    - Businesses rely upon each other.

**Created New 20 Percent Deduction**

- Issues with the wage limitations
  - Guaranteed payments do not count
  - Wages paid by a management company cannot be allocated
  - PEO wages do qualify
### Example 1: Full Deduction

**Facts**
- Sole proprietorship
- Filing status is single
- Manufacturer of widgets
- No employees
- For tax year ending December 31, 2018
  - Taxable income of $100,000
  - Compensation to owner: $0
  - Qualified business income of $100,000
  - Purchased widget-making machine for $100,000

**QBI deduction = $20,000**
- 20 percent of QBI: $20,000
- 50 percent of W-2 wages: $0 ($0 x 0.50 = $0)
- 25 percent of W-2 wages: $2,500 ($100,000 x 0.025 = $2,500)
- 2.5 percent of unadjusted basis of qualified property: $20,000

### Example 2: Limited to UBIA

**Facts**
- Sole proprietorship
- Filing status is single
- Manufacturer of widgets
- No employees
- For tax year ending December 31, 2018
  - Taxable income of $1,000,000
  - Compensation to owner: $0
  - Qualified business income of $1,000,000
  - Purchased widget-making machine for $1,000,000

**QBI deduction = $25,000**
- 20 percent of QBI: $200,000
- 50 percent of W-2 wages: $0 ($0 x 0.50 = $0)
- 25 percent of W-2 wages: $25,000 ($1,000,000 x 0.025 = $25,000)
- 2.5 percent of unadjusted basis of qualified property: $25,000
Example 3: Limited to Wages

Facts

- S corporation
- Filing status is single
- Manufacturer of widgets
- No employees other than owner
- For tax year ending December 31, 2018
  - Taxable income of $1,000,000
  - Compensation to owner: $100,000
  - Qualified business income of $900,000
  - Purchased widget-making machine for $1,000,000

QBI deduction = $50,000

- 20 percent of QBI $180,000
- 50 percent of W-2 wages $50,000 ($100,000 x .50 = $50,000)
- 25 percent of W-2 wages $50,000 (($100,000 x .25) +
  + 2.5 percent of unadjusted basis of qualified property ($1,000,000 x .025) = $50,000)

SCENARIO 1: QBI DEDUCTION

<table>
<thead>
<tr>
<th>Business income</th>
<th>Previous Tax Law</th>
<th>New Tax Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Income</td>
<td>$940,000</td>
<td>$940,000</td>
</tr>
<tr>
<td>State income tax (entity level)</td>
<td>-60,000</td>
<td>-60,000</td>
</tr>
<tr>
<td>Federal income tax on business income</td>
<td>-319,600</td>
<td>-221,295</td>
</tr>
<tr>
<td>Total tax</td>
<td>($564,479)</td>
<td>($385,623)</td>
</tr>
<tr>
<td>Net cash to owner</td>
<td>$435,521</td>
<td>$521,305</td>
</tr>
<tr>
<td>Combined effective tax rate</td>
<td>56.45%</td>
<td>47.87%</td>
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</tbody>
</table>

9/18/2019
**SCENARIO 2: NO QBI DEDUCTION**

<table>
<thead>
<tr>
<th></th>
<th>Previous Tax Law</th>
<th>New Tax Law</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Corp</td>
<td>S Corp</td>
</tr>
<tr>
<td>Business income</td>
<td>$1,000,00</td>
<td>$1,000,00</td>
</tr>
<tr>
<td>Pass-through business deduction</td>
<td>-</td>
<td>-</td>
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<tr>
<td>State income tax (entity level)</td>
<td>(60,000)</td>
<td>-</td>
</tr>
<tr>
<td>Taxable income</td>
<td>940,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>State income tax (shareholder level)</td>
<td>-</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Federal income tax on business income</td>
<td>(319,600)</td>
<td>(325,623)</td>
</tr>
<tr>
<td>Tax on distribution to owner</td>
<td>(184,879)</td>
<td>-</td>
</tr>
<tr>
<td>Total tax</td>
<td>(564,479)</td>
<td>(385,623)</td>
</tr>
<tr>
<td>Net cash to owner</td>
<td>$435,521</td>
<td>$514,377</td>
</tr>
<tr>
<td>Combined effective tax rate</td>
<td>56.45%</td>
<td>38.56%</td>
</tr>
</tbody>
</table>

**SCENARIO 3: RETAIN 50% OF INCOME**

<table>
<thead>
<tr>
<th></th>
<th>Previous Tax Law</th>
<th>New Tax Law</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Corp</td>
<td>S Corp</td>
</tr>
<tr>
<td>Business income</td>
<td>$1,000,00</td>
<td>$1,000,00</td>
</tr>
<tr>
<td>Pass-through business deduction</td>
<td>-</td>
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<tr>
<td>State income tax (entity level)</td>
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</tr>
<tr>
<td>Taxable income</td>
<td>940,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>State income tax (shareholder level)</td>
<td>-</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Federal income tax on business income</td>
<td>(319,600)</td>
<td>(325,623)</td>
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<tr>
<td>Tax on distribution to owner</td>
<td>(92,440)</td>
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<tr>
<td>Total tax</td>
<td>(472,040)</td>
<td>(385,623)</td>
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<tr>
<td>Net cash to owner</td>
<td>217,760</td>
<td>114,377</td>
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<tr>
<td>Net cash retained in business</td>
<td>310,200</td>
<td>500,000</td>
</tr>
<tr>
<td>Total net cash after taxes</td>
<td>$527,960</td>
<td>$514,377</td>
</tr>
<tr>
<td>Combined effective tax rate</td>
<td>47.20%</td>
<td>38.56%</td>
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• Additional resources available at bkd.com/taxreform
  • “Pass-Through Business Deduction” flowchart
  • “The Qualified Business Income Deduction Under the Tax Cuts and Jobs Act” white paper
  • “Simply Tax” podcast
    • Episode 54: “Putting the §199A Pieces Together”
  • Webinars
    • “The QBI Deduction: Insights on the Latest Guidance”

Expires after December 31, 2025

• Fringe benefit deductions
  • Qualified transportation fringe benefits not deductible
  • Employee reimbursed moving expenses not excludable from employee income
Entity Choice Options

• Why be a C corporation?
• Why be an S corporation?
• Why be a partnership?

Added Qualified Opportunity Zones

• **Qualified opportunity (QO)**
  - **Zones**: low-income census tracts identified by stats
  - **Fund**: corporation or partnership that invests in QO zone property
  - Businesses with substantially all tangible property owned or leased in QO zone
  - Cannot be golf course, country club, gaming, etc.
Temporary Deferral of Gain

• 180-day reinvestment of gain directly in fund

• Deferral ends on earlier of date of next sale, or 2026

• Percentage of deferred gain recognized depends on length of holding period
  • < 5 years: **100 percent**
  • > 5 but < 7 years: **90 percent**
  • > 7 years: **85 percent**

Added Qualified Opportunity Zones

Questions?
Thank You!

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